Supreme Court, U.S.
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AUG 8 1988
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88-274

No. _____

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1987

DAVID O. WILSON, Petitioner,

v.

ANNA M. HARELSON, et al., Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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August 8, 1988

QUESTION PRESENTED

1. Does the Supreme Court's holding in Pinter v. Dahl, _____ U.S. _____ [Current], Fed. Sec. L. Rep. (CCH), ¶ 93,790, 88 Daily Journal D.A.R. 7654 (June 15, 1988), extend liability for the sale of unregistered securities under section 12(1) of the Securities Act to a person who presented an investment opportunity at the request of the buyer, but did not solicit the buyer or recommend the purchase, although he was motivated to assist the buyer by the promise of commission?

LIST OF PARTIES AND RULE 28.1 STATEMENT

The parties to the proceedings below were the petitioner David O. Wilson and the respondents Anna M. Harelson, Anna M. Harelson, Ph.D., Inc., Defined Benefit Plan, Louis Rigali and Julianne Rigali.

The respondents before this Court are Anna M. Harelson, Anna M. Harelson, Ph.D., Inc., Defined Benefit Plan, Louis Rigali and Julianne Rigali.

Petitioner David O. Wilson has no parent companies, subsidiaries, or affiliates to list pursuant to Supreme Court Rule 28.1.

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No. _____

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1987

DAVID O. WILSON, Petitioner,

v.

ANNA M. HARELSON, et al., Respondents.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

The petitioner respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit, entered in the above-entitled proceeding on May 9, 1988.

OPINIONS BELOW

The majority opinion and concurring opinion of the Court of Appeals for the Ninth Circuit is reported at 846 F.2d 53, [Current] Fed. Sec. L. Rep. (CCH), ¶ 93,751, 88 Daily Journal D.A.R. 5722 (9th Cir. May 9, 1988) and is reprinted in the appendix hereto, p. A-1, infra.

The June 3, 1986 memorandum decision and the December 15, 1986 order of amended judgment of the United States District Court for the Northern District of California (Lynch, D.J.) have not been reported. They are reprinted in the appendix hereto, p. A-15, and p. A-11, infra, respectively.

JURISDICTION

Invoking federal jurisdiction under 15 U.S.C. § 77l and 17 C.F.R. § 240.10b-5, the respondents brought this suit in the Northern District of California. On June 3, 1986, the Northern District found

that petitioner was a "substantial factor" in the sale of an unregistered security and therefore liable as a "seller" under § 12(1) of the Securities Act of 1933, 15 U.S.C. § 77l.

On petitioner's appeal, the Ninth Circuit on May 9, 1988, affirmed the Northern District's judgment of liability and remanded for entry of judgment.

The jurisdiction of this Court to review the judgment of the Ninth Circuit is invoked under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

The statute involved is § 12(1) of the Securities Act of 1933 ("Securities Act"), 48 Stat. as amended, 15 U.S.C. § 77a, et seq., which states:

> Sec. 12. Any person who --
>
> (1) offers or sells a security in violation of section 5, or
>
> (2) offers or sells a security (whether or not exempted by the provisions

of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

STATEMENT OF THE CASE

In 1984 respondents brought suit in the United States District Court for the Northern District of California against petitioner David O. Wilson and other defendants for alleged violations of the federal securities laws. [1]

This action arose as a result of respondents' purchases of certain short-term, high yield promissory notes, on which the issuer, the Carter Company, defaulted. As described in the brochure

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[1] Respondents' allegations included the following violations: (1) § 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b); and Securities & Exchange Commission ("SEC") Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5; (liability for material misrepresentation or omission in purchase or sale of security); (2) § 12(2) of the Securities Act, 15 U.S.C. § 77*l*(2) (civil liability for selling securities by means of a communication containing a material omission or misrepresentation); and (3) § 12(1) of the Securities Act, 15 U.S.C. § 77*l*(1) (civil liability for selling an unregistered security).

prepared by the Carter Company, the money received by the company in the sale of promissory notes purportedly was used to purchase medical accounts receivable at a substantial discount. The Carter Company then would endeavor to collect on those accounts. According to the Carter Company, investors could purchase 90-day promissory notes, which would yield an annual return of approximately 20-30%, depending on how successful the Carter Company was in its collection of those claims. [2]

In 1983, petitioner became an agent for Miller Financial Corporation which, in turn, was a sales agent for the Carter Company. [3] Petitioner neither solicited

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[2] Honorable Eugene Lynch's Memorandum Opinion dated June 3, 1986, ("Mem. Op."), p. 10, lns. 8-12, Appendix III at A-32.

[3] Mem. Op. p. 9, lns. 14-15, Appendix III at A-30.

investors nor acted as a broker, dealer, underwriter or investment advisor in connection with the sale of Carter Company notes. [4] Petitioner received a commission when investors purchased Carter Company promissory notes.

During the summer of 1983, respondents purchased Carter Company promissory notes. [5] In connection with those purchases, petitioner played a very limited role. For example, respondent Harelson and the respondents Rigalis, separately, initiated contact with petitioner to arrange a meeting. In response to their telephone calls

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[4] Mem. Op. p. 18, lns. 8-11, Appendix III at A-47.

[5] Mem. Op. p. 10, lns. 26-28, p. 11, ln. 1, Appendix III at A-33.

petitioner met with both parties on separate occasions.[6]

The content of the meetings with respondent Harelson and the respondents Rigalis was virtually identical.[7] Reiterating the contents of the brochure produced by the Carter Company,[8] petitioner explained how the medical factoring program worked.[9]

He described the investment by paraphrasing the content of the Carter

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[6] Mem. Op. p. 9, lns. 17-22, Appendix III at A-30-31; Harelson v. Miller Financial Corp., 846 F.2d 53, 54 (9th Cir. May 9, 1988), Appendix I at A-6.

[7] Mem. Op. p. 9, lns. 23-25, Appendix III at A-31.

[8] Mem. Op. p. 4, lns. 19-22, Appendix III at A-21; p. 6, lns. 6-10, Appendix III at A-24; p. 9, lns. 25-28, Appendix III at A-31.

[9] Mem. Op. p. 9, lns. 25-28, p. 10, lns. 1-4, Appendix III at A-31.

Company brochure. At no time did petitioner recommend the investment.[10]

After respondents made the decision to purchase Carter Company promissory notes, petitioner assisted them in completing the requisite forms. Afterwards, he accepted their checks, made out to the Carter Company, which he then forwarded to the Carter Company.[11] Petitioner did not negotiate with respondents regarding either the rate of return on the subject promissory notes or any other aspect of the transaction.[12]

The action was tried before the Hon. Eugene Lynch on February 10, 1986. On June 3, 1986, the district court found

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[10] Mem. Op. p. 18, lns. 8-11, lns. 25-28, p. 19, ln. 1, Appendix III at A-48.

[11] Mem. Op. p. 11, lns. 1-2, Appendix III at A-33.

[12] Mem. Op. p. 10, lns. 11-12, Appendix III at A-32.

liability only under § 12(1) of the Securities Act, holding that petitioner was a "seller" of unregistered securities under the Ninth Circuit's "substantial factor" test, entitling respondents to rescission.[13]

Although the district court concluded that the promissory notes at issue were "securities" under the federal securities laws, the district court found, contrary to respondents' allegations, no violation of § 10(b) or Rule 10b-5 under the Exchange Act, no breach of fiduciary duty

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[13] Mem. Op. p. 11, lns. 2-5, Appendix III at A-33. On June 30, 1986, petitioner filed a motion for reconsideration of the district court's June 3, 1986, memorandum opinion, pursuant to Rule 52 of the Federal Rules of Civil Procedure to request, inter alia, the district court to reconsider its holding that petitioner was a § 12(1) "seller." On December 15, 1986, the district court rejected petitioner's argument that he was not a "seller" within the meaning of § 12(1). Order and Amended Judgment dated December 15, 1986 ("AM.JM."), p. 2, Appendix II at A-12.

and no common law fraud. In addition, the district court found no liability under § 12(2) of the Securities Act on the grounds that petitioner's conduct was sufficiently innocent of any fraud to entitle him to the "reasonable care defense," i.e., "that [he] did not know, and in the exercise of reasonable care could not have known, of the untruth or material omission in the offer or sale of the security."

On May 9, 1988, the Ninth Circuit rejected petitioner's arguments that (1) strict privity governed the parameters of seller liability under § 12(1) of the Securities Act, 15 U.S.C. 77l(1) and (2) under the Ninth Circuit's "substantial factor" test petitioner's limited activities did not permit a finding that he was a "seller" within the meaning of § 12(1). The Ninth Circuit held that petitioner was a "but for" cause of the

sale under the "substantial factor" test.[14]

REASONS FOR GRANTING THE WRIT

I. The Ninth Circuit's Decision Conflicts With A Recent Decision Of This Court That Significantly Changes The Law

A. Pinter v. Dahl Changed The Standard Governing Seller Liability Under § 12(1)

The decision of the Court of Appeals for the Ninth Circuit in this case is in conflict with this Court's decision in Pinter v. Dahl, _____, U.S. _____, [Current] Fed. Sec. L. Rep. (CCH) ¶ 93,790, 88 Daily Journal D.A.R. 7654 (June 15, 1988). In Pinter, this Court rejected the "substantial factor" test applied by lower federal courts to impose § 12(1) liability on persons other than

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[14] Harelson v. Miller Financial Corp., supra, 846 F.2d at 55, Appendix I at A-9.

the owner of a security in a buy-sell transaction. This Court held that the "substantial factor" test was a gross departure from the statutory language and that "the substantial-factor test reaches participants in sales transactions who do not even arguably fit within the definitions set out in § 2(3)." Pinter, supra, 88 Daily Journal D.A.R. at 7661. More importantly, this Court held "[b]eing merely a 'substantial factor' in causing the sale of unregistered securities is not sufficient in itself to render a defendant liable under § 12(1)." Id. [15]

In rejecting the "substantial factor" test, this Court announced that "the language and purpose of section 12(1)

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[15] The Supreme Court specifically acknowledged the Ninth Circuit's special version of the substantial factor test citing SEC v. Rogers, 790 F.2d 1450 (9th Cir. 1986). Pinter, supra, 88 Daily Journal D.A.R. at 7664 n. 25.

suggest that liability extends only to the person who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner." Pinter, supra, 88 Daily Journal D.A.R. at 7660. The standard for determining whether a person is a statutory seller under § 12(1) is solicitation coupled with some financial benefit.

Since the Ninth Circuit, and the Northern District, applied the substantial factor test rejected by this Court to petitioner's limited activities and held petitioner liable as a "seller" under § 12(1), petitioner submits that the decisions of the Ninth Circuit and the Northern District should be reversed.

B. Under Pinter v. Dahl Petitioner's Limited Activities Do Not Support A Finding Of "Seller" Liability Under § 12(1)

Under Pinter v. Dahl, solicitation coupled with financial benefit define the parameters of "seller" liability under § 12(1). This Court referred to solicitation as "the stage at which an investor is most likely to be injured, that is, by being persuaded to purchase securities without full and fair information." Pinter, supra, 88 Daily Journal D.A.R. at 7660.

In Pinter v. Dahl, this Court was unable to determine whether Dahl, a person other than the issuer or owner of an unregistered security, may have been liable as a statutory seller under § 12(1). This Court noted the district court's express finding that Dahl solicited each of the investors in connection with the offer, and found the

Fifth Circuit's conclusion that Dahl was motivated "entirely by a gratuitous desire" to be premature. In short, this Court acknowledged the solicitation finding and remanded for further findings on the issue of financial benefit. Pinter, supra, 88 Daily Journal D.A.R. at 7661.

In the instant case, the Northern District expressly found that petitioner Wilson, an agent for the agent for the seller, made no recommendation to the respondents. Thus, petitioner did not solicit the respondents.[16] The respondents contacted petitioner to

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[16] By solicit, we assume the Court was referring to the act of recommending or importuning. See, e.g., Black's Law Dictionary 1248-49 (5th ed. 1979) and the American Heritage Dictionary 646, 1163 (2nd ed. 1985). To the extent the Court meant to use the term "solicit" in a different context, this case presents the Court with the opportunity to resolve any ambiguity.

arrange a meeting. At the meeting, petitioner paraphrased the contents of a brochure and explained the investment. Petitioner did not recommend the investment to respondents or act as a broker at the meeting. [17] When respondents determined to make an investment, petitioner merely assisted them in the completion of the forms and accepted their checks for forwarding to the issuer, the Carter Company.

Similarly, the Ninth Circuit made no suggestion in its decision that petitioner solicited the respondents. The Ninth Circuit stated "[petitioner] did not personally seek out the customers, but like a car salesman, waited for them to come to his place of business." Harelson v. Miller Financial Corp., supra, 846 F.2d

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[17] Mem. Op. p. 18, lns. 8-9, Appendix III at A-47.

at 54 . Although petitioner did not solicit the respondents, he did receive a financial benefit in the form of a commission for his effort.[18]

Applying the "solicitation-financial benefit" test of Pinter, in the absence of a finding that petitioner solicited the purchase, there can be no § 12(1) liability. Petitioner submits that the findings of the district court and the decision of the Ninth Circuit supports the conclusion that petitioner's limited activities in response to the respondents' request did not rise to a "solicitation."

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[18] Petitioner also invested personally in the Carter Company promissory notes. Mem. Op. p. 10, lns. 20-22, Appendix III at A-33; Mem. Op. p. 16, lns. 6-7, Appendix III at A-43. When the Carter Company defaulted on the notes, petitioner, like respondents, suffered substantial loss.

CONCLUSION

For the foregoing reasons, this petition for certiorari should be granted. If the petitioner is correct in urging that financial benefit without solicitation is an insufficient basis to support a finding of liability under § 12(1), the matter should be reversed and remanded to the Northern District for appropriate disposition.

DATED: August 8, 1988

Respectfully submitted,

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APPENDIX I

[846 F.2d 53]

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

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ANNA M. HARELSON; ANNA M.          )
HARELSON, PHD., INC.; DEFINED      )
BENEFIT PLAN; LOUIS A. RIGALI;     )
JULIANNE RIGALI,                   )
          Plaintiffs-Appellees/)
              Cross-Appellants,)
                                   )
          v.                       )
                                   )
MILLER FINANCIAL CORPORATION, a)
California corporation;            )
                      Defendant,)
                                   )
          and                      )
                                   )
DAVID O. WILSON,                   )
         Defendants-Appellants/)
              Cross-Appellees.)
___________________________________)
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Nos. 87-1584; 87-1653

D.C. No. CV-84-4269-EFL

OPINION

Appeals from the United States
District Court
for the Northern District of California
Eugene F. Lynch, District Judge, Presiding

Argued and Submitted
December 17, 1987-San Francisco, California

Filed May 9, 1988

Before: Betty B. Fletcher, Charles Wiggins
and John T. Noonan, Jr., Circuit Judges.

Opinion by Judge Noonan;
Concurrence by Judge Fletcher

SUMMARY

Securities

Appeal from judgment. Affirmed in part, reversed in part and remanded. The court found appellant a seller of securities and that the statute of limitations does not bar the party's claims.

Wilson was an agent with Miller Financial, which was an agent for the Carter Co. Wilson was paid a commission on promissory notes of the Carter Co. which he sold. Rigali sought out and met with Wilson, as did Harelson. At each of the meetings Wilson used a brochure to explain its program. He helped the appellees complete forms by which they invested in exchange for promissory notes of the Carter Co. Harelson and the Rigalis invested. Wilson accepted the

checks. When the Carter Co. defaulted, the plaintiffs sued.

[1] Wilson was a seller within the meaning of section 12(1) of the Securities Act. [2] He was the "but for cause" of the sale; his participation was more than de minimis; his acts were a "substantial factor" in the transactions.

Judge Fletcher concurred in the result.

COUNSEL

Robert A. Huddleston, Tonsing, Heimann & Huddleston, Danville, California, for the plaintiffs-appellees-cross-appellants.

Deborah A. Klar and Michael F. Perlis, Pettit & Martin, San Francisco, California, for the defendants-appellants/cross-appellees.

OPINION

NOONAN, Circuit Judge:

Anna M. Harelson, Anna M. Harelson, Ph.D., Inc. Defined Benefit Plan, Louis A. Rigali and Julianne J. Rigali sued David O. Wilson and others alleging violation of Section 12(1) of the Securities Act of 1933, 15 U.S.C. § 77l(1) and other wrongs. The case was tried in the district court without a jury. The court found for the defendant on several counts but gave judgment for the plaintiffs on their Section 12(1) claims, limiting recovery by application of the statute of limitations. Wilson appeals the judgment that he was a seller of the securities; the Rigalis appeal the application of the statute of limitations. We affirm the district court's judgment of liability and hold that the statute of limitations is not a

barrier to the Rigali claims. We remand for entry of judgment on these claims.

FACTS

In 1983 Wilson became an agent with Miller Financial Corporation, which was an agent for the Carter Company, a corporation engaged in the business of factoring the claims of doctors. Wilson was paid a commission on promissory notes of the Carter Company which he sold. Louis Rigali heard about the Carter Company from Wilson's brother and made an appointment for himself and his wife to see Wilson, who met with them on June 22, 1983. Wilson met with Harelson on July 1, 1983 after arranging an appointment in response to her telephone call.

At each of the meetings Wilson used a brochure produced by the Carter Company to explain its program of factoring doctors' claims. He stated that an investor would

receive a return of 7 percent over 90 days on the amount invested but that the rate or return could vary from 20 percent annually to 30 to 33 percent annually depending on the company's success. He stated that in the seven-year history of the company it had never failed to pay an investor. He said that he himself had invested in the company. He said that Mr. Carter was a man of substantial means. At the conclusion of each meeting he helped the plaintiffs complete forms by which they invested in exchange for promissory notes of the Carter Company.

Harelson invested $34,500 on behalf of her corporation's Defined Benefit Plan; the Rigalis invested $13,000. Wilson accepted the checks of the plaintiffs. On June 27, 1983 he forwarded the Rigalis' checks to the Miller Financial

Corporation. He forwarded Harelson's check on some date after July 1, 1983.

When the Carter Company defaulted the plaintiffs brought this suit on June 25, 1984.

ANALYSIS

[1] 1. Wilson as a Seller. David O. Wilson and the archetypal American salesman, Willie Loman, are scarcely distinguishable. On the facts found by the district court, Wilson was a seller within the meaning of § 12(1) of the Securities Act of 1933, 15 U.S.C. § 77l(1). Wilson did not personally seek out the customers, but, like a car salesman, waited for them to come to his place of business. He presented the basic facts necessary to effectuate a sale. His use of a company brochure was typical of any salesman offering a product. He was

compensated for the work he did in bringing the sales about.

[2] SEC v. Rogers, 790 F.2d 1450 (9th Cir. 1986), relied on by Wilson in this court, is irrelevant: in that case the district court had found as a fact that the defendant had not been a "salesman." To the contrary, in this case the district court, on the basis of ample evidence, found Wilson was a salesman. He was the "but for cause" of the sale. His participation was far more than de minimis. His acts were "a substantial factor" in the transactions. SEC v. Murphy, 626 F.2d 633, 650-652 (9th Cir. 1980).

2. Statute of Limitations. The statute of limitations began to run when Wilson ceased to participate in the sale. That participation as to the Rigalis did not cease until he delivered their check

to Miller Financial Corporation on June 27, 1983. Accordingly, he is liable for the sale to the Rigalis.

AFFIRMED IN PART, REVERSED IN PART AND REMANDED TO ENTER JUDGMENT FOR THE RIGALIS. Costs are to be borne by Wilson.

FLETCHER, Circuit Judge:

I concur in the result.

APPENDIX II

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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

ANNA M. HARELSON, et al., Plaintiffs, vs. MILLER FINANCIAL CORPORATION, a California corporation, et al. Defendants.	Case No. C-84-4269 EFL ORDER AND AMENDED JUDGMENT

Based upon the Decision of the Court filed herein on June 4, 1986, the Court entered Judgment on July 25, 1986. Pursuant to defendant David O. Wilson's ("Wilson") Motion for Reconsideration, it

is hereby ordered that the Memorandum Opinion of this Court dated June 4, 1986, is amended to reflect that the claim of plaintiffs Louis and Julianne Rigali, under Section 12(1) of the Securities Act of 1933 (15 U.S.C. § 77l(1)), resulting from their purchase of Carter Company Promissory Notes on June 22, 1985, is barred by the applicable statute of limitations.

Accordingly, the Court's Judgment dated July 25, 1986, is modified and an Amended Judgment is entered herein as follows:

1. In favor of plaintiffs Anna Harelson, The Anna Harelson Defined Benefit Plan, and Louis and Julianne Rigali and against defendant David O. Wilson, in the following amounts:

(a) Principal amount of $20,000.00, plus interest at the legal rate on this principal amount from July 1, 1983;

(b) Principal amount of $10,000.00, plus interest at the legal rate on this principal amount from July 11, 1983;

(c) Principal amount of $4,500.00, plus interest at the legal rate on this principal amount from August 10, 1983;

(d) Principal amount of $1,000.00, plus interest at the legal rate on this principal amount from September 18, 1983; and

(e) Less $4,000.00 received from defendant Mark Miller, together with interest at the legal rate from August 1, 1985.

2. In favor of defendant David O. Wilson Financial Corporation and against plaintiffs.

3. Each party to bear their own costs of suit.

4. Execution of this Judgment is stayed for 30 days without bond. Any stay of execution beyond 30 days must be accompanied by a bond.

DATED: December 15, 1986

____

The Honorable Eugene F. Lynch,
Judge of the U.S. District Court

APPROVED AS TO FORM:

____

Attorneys for David O. Wilson
and David O. Wilson Financial
Corporation

APPENDIX - III

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

ANNA M. HARELSON, et al., Plaintiffs, vs. MILLER FINANCIAL CORPORATION, et al., Defendants.	)	No. C-84-4269 EFL MEMORANDUM OPINION

INTRODUCTION

Plaintiffs Anna M. Harelson, the defined benefit plan of her corporation, Louis A. Rigali, and Julianne J. Rigali brought suit against the Miller Financial Corporation, Mark D. Miller, [1] David O.

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[1] Both of the Miller entities were dismissed from the case by stipulation and order of August 20, 1985.

Wilson Financial Corporation [2] and David O. Wilson alleging: 1) violation of section 12(1) of the Securities Act of 1933, 15 U.S.C. section 77l(1) (civil liability for selling an unregistered security); 2) violation of section 12(2) of the Securities Act of 1933, 15 U.S.C. section 77l(2) (civil liability for sale of a security by means of a communication

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[2] David O. Wilson became an agent for Miller Financial Corporation on September 29, 1982; David O. Wilson Financial Corporation became an agent for Miller Financial Corporation on August 15, 1983. Plaintiff has adduced no evidence other than the agency agreement with Miller Financial Corporation signed by Wilson on behalf of his financial corporation to indicate the role played by David O. Wilson Financial Corporation. As at least some of the actions complained of occurred before the David O. Wilson Financial Corporation was an agent for Miller Financial Corporation, the Court cannot assume that the two Wilson entities are identical. As no evidence relating the actions of David Wilson to David O. Wilson Financial Corporation has been produced, the Court hereby dismisses the claims against David O. Wilson Financial Corporation.

containing a material misrepresentation or omission); 3) violation of SEC Rule 10b-5, 17 C.F.R. section 240.10b-5 (material misrepresentation or omission in offer or sale of security is unlawful); 4) violation of the California Corporations Code analogues to sections 12(1) and 12(2) of the Securities Act of 1933;[3] 5) fraud and deceit; and 6) breach of fiduciary duty. See First Amended Complaint (filed Nov. 19, 1984, following the partial granting of defendants' motion to dismiss).

During the summer of 1983, Wilson met separately with Harelson and the Rigalis and made a presentation to them about investing in a medical factoring program operated by the Carter Company. At the

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[3] Counsel for plaintiffs stipulated at trial to the dismissal of the California Corporations Code claims. Transcript at 91.

conclusion of those meetings, Harelson invested $34,500 on behalf of her corporation's defined benefit plan, and the Rigalis invested $13,000. At issue is whether or not Wilson's conduct violated federal securities laws or common law duties owed to these plaintiffs.

The case was tried before this Court without a jury on February 10, 1986. For the reasons explained below, the Court finds that although Wilson committed no fraud or breach of fiduciary duty, because he sold an unregistered security, plaintiffs are entitled to recover the consideration paid plus interest.

DISCUSSION

I. Violations of Section 12.

A. Was There a Security?

Liability can be found under sections 12(1) and 12(2) of the Securities Act of 1933, and Rule 10b-5, promulgated under the Securities and Exchange Act of

1934, only if the transactions involved a <u>security</u>. Because the definition of a security in the two acts has been held to be virtually identical, [4] the same analysis applies in deciding whether a transaction involves a security under either act. <u>Ahern v. Gaussoin</u>,

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[4] There is a notable difference in the treatment of short-term notes in the two acts. The 1933 Act defines as securities and exempts from registration, but not the anti-fraud provisions, notes arising from current transactions that mature in less than nine months. 15 U.S.C. section 77c(3). The 1934 Act excludes short-term paper from the definition of a security. 15 U.S.C. section 78c(a)(10). However, the statutes are read <u>in pari materia</u> so that the 1934 Act anti-fraud provisions apply to short-term notes that satisfy the test, discussed below, for being a security. <u>See</u> L. Loss, <u>Fundamentals of Securities Regulation</u>, 170 n.a (1983). Defendants have not contended that the 1933 Act exemption from registration for short-term paper applies, 15 U.S.C. section 77c(a)(3), and it is clear that it does not. <u>See</u>, <u>e.g.</u>, <u>S.E.C. v. American Board of Trade, Inc.</u>, 751 F.2d 529, 538-40 (2d. Cir. 1984) (exemption available only for prime quality negotiable commercial paper).

611 F. Supp. 1465, 1474 (D. Or. 1985) (citing Tcherepnin v. Knight, 389 U.S. 332 (1967); Wright v. Schock, 571 F. Supp. 642, 646 (N.D. Cal. 1983), aff'd, 742 F.2d 541 (9th Cir. 1984)).

In ascertaining whether a security was involved, the Court must determine whether the particular transactions were "investments," to which the protection of the federal securities laws would then attach, or "commercial lending situations," which are outside the scope of the federal securities laws. Underhill v. Royal, 769 F.2d 1426, 1430 (9th Cir. 1985).

In this Circuit, to classify the transaction the Court must apply the "risk capital test" and determine whether the plaintiffs contributed risk capital subject to the entrepreneurial or managerial efforts of others. Id. at 1431 (quoting United California Bank v. THC

Financial Corp., 557 F.2d 1351, 1358 (9th Cir. 1977)). The Ninth Circuit has provided a non-exhaustive list of six factors, none dispositive, to determine whether risk capital was contributed. Underhill, 769 F.2d at 1431 (citing Great Western Bank & Trust v. Kotz, 532 F.2d 1252, 1257-58 (9th Cir. 1976)). The six factors are:

1. The Form of the Obligation. Plaintiffs received from the Carter Company a document entitled "Medical Factoring Agreement," Plaintiff Exhibit No. 27, and promissory notes, Plaintiff Exhibit Nos. 25, 26. The brochure produced by the Carter Company that Wilson showed to plaintiffs in making his presentation described the contribution as "a loan to the company . . . ." Plaintiff Exhibit No. 16.

The brochure, the agreement, and the notes indicated that the investor would

receive a return of seven percent quarterly. Wilson also explained that the investor would receive a return of seven percent every 90 days on the amount invested. However, he apparently indicated that the rate of return could vary from an annual rate of 20 percent up to an annual rate of 30 or 33 percent depending on how successful the Carter Company was at collecting on the claims. The brochure indicated that the then current rate of return was seven percent per quarter, but that in the past the return had been that high or higher. The factoring agreements allowed that the rate of return could vary from quarter to quarter but that notice of any change would be provided to the investor in writing.

Plaintiff Harelson testified that although she had read the brochure indicating that the contribution was a

loan, it had not been explained to her that way, and she did not think she was buying a note. Transcript at 38-39.

2. The Circumstances of Issuance. The Court was provided with no evidence as to how widespread the marketing of the interests in the factoring program was or what the nature of the class of investors was. However, the terms of the contribution were not negotiated individually with each investor. The parties here signed identical standardized factoring agreements, and there was no negotiation of the rate of return. In fact, under the terms of his contract with the Miller Financial Corporation, Wilson was not authorized to sell contracts on terms different from those specified by the Miller Financial Corporation. Thus, the possibility of individualized factoring agreements was slight.

3. <u>Time</u>. The brochure, factoring agreement, and promissory notes stated that the contribution plus any return would be available after 90 days. In order to receive the principal or gains, plaintiffs had to provide written notice two weeks before the maturity date. If the Carter Company was not notified of the desire to withdraw, the contribution would be rolled over for another 90 days. Plaintiffs allowed their principal to roll over.

4. <u>Collateralization</u>. The brochure of the Carter Company asserted that the assets of the Carter Company, which included the claims against the insurance companies that were the focus of the factoring program and "substantial non-related assets," protected the contributors. However, there is no evidence of any security agreement, and the factoring agreement and promissory

notes do not indicate that there is any collateral for the loans. Thus, the contributors were unsecured creditors.

5. The Contemplated Use of the Contributions. The brochure indicated that the contributions would be used to purchase claims against insurance companies from doctors.

6. The Relationship Between the Amount Borrowed and the Size of the Borrower's Business. The Court received no evidence as to the amount raised by the Carter Company through the program in which plaintiffs invested, thus there is no way to determine whether the factoring agreement and note combination represented a large or small amount in relation to the Carter Company's business.

Finding the facts to be as just described, the Court concludes that plaintiffs contributed risk capital. Consequently, the contributions and

receipt of the factoring agreements and notes were investments to which the protection of the federal securities laws attach.

Even though the Carter Company called the obligation a loan, the name given is not controlling. Ahern, 611 F. Supp. at 1475 (citing Willamette Savings & Loan v. Blake & Neal Finance Co., 577 F. Supp. 1415, 1421 (D. Or. 1984)). Thus, the form of the obligation, which was a note and a factoring agreement, provides little support for the argument that securities were not involved here.

Short-term notes are seldom securities. Willamette Savings & Loan, 577 F. Supp. at 1421. However, this case involves a factoring agreement in addition to the notes. Moreover, where, as here, there is an expectation of roll-overs, the significance of the time factor of the notes is diminished. Ahern, 611 F. Supp.

at 1476; cf. Underhill, 769 F.2d at 1431 (notes that were callable were still securities where the fact that they were callable was not emphasized).

It appears that the funds were not to be used simply for helping the Carter Company meet its operational expenses. The contributions were to be used to create the fund with which purchases of the accounts receivable were to be made. Thus, the contributions resemble a risky funding of enterprise formation rather than the relatively safe funding of current operations. See Great Western Bank & Trust, 532 F.2d at 1258.

The lack of meaningful collateralization and the circumstances of issuance cut powerfully in the direction that securities were involved here.

Although it was suggested to plaintiffs that the insurance claims and other assets of the Carter Company

supported the obligation to repay the loan, there was no indication that plaintiffs had any opportunity to obtain a security interest in those assets. Nor was there a showing as to what tangible assets were potential collateral for plaintiffs' "loans." In short, the plaintiffs were dependent on the managerial skills of the Carter Company for the return of their money. See Great Western Bank & Trust, 532 F.2d at 1258.

Similarly, the lack of individual negotiation and the fact the "loan" obligations were extended by the Carter Company to more than a single party make the transaction resemble an investment far more than a commercial loan. See Underhill, 769 F.2d at 1431.

In sum, the plaintiffs contributed money to be used by the Carter Company to purchase accounts receivable. Plaintiffs did not negotiate the terms of the

transaction, as would be expected in a commercial transaction, and plaintiffs could count on little more than the good judgment of the Carter Company for the return of their money. Given these circumstances, the Court finds that the plaintiffs were investing in a risky enterprise and the notes and factoring agreement constitute a security. See Underhill, 769 F.2d at 1431 (where investors received a loan agreement and promissory note for contributing money to be used to purchase third party promissory notes secured by a deed of trust, the investors purchased a security).

B. Was Wilson a "Seller"?

Sections 12(1) and 12(2) include "any person who offers or sells a security" within their ambit of potential liability. The test for whether or not a participant in a transaction is liable as a seller under section 12 "is whether the

injury to the plaintiff flowed directly and proximately from the actions of the defendant." Anderson v. Aurotek, 774 F.2d 927, 930 (9th Cir. 1985); Admiralty Fund v. Jones, 677 F.2d 1289, 1294 (9th Cir. 1982). "Before a person's act can be considered the proximate cause of a sale, his acts must also be a substantial factor in bringing about the transaction." SEC v. Murphy, 626 F.2d 633, 650 (9th Cir. 1980).

The testimony revealed very little conflict over Wilson's role in the sales of the securities.

Wilson was an agent for the Miller Financial Corporation, which was, in turn, the sales agent for the Carter Company. Wilson received a commission for obtaining investors in the factoring program. He met with both the Rigalis on June 22, 1983 after having met with Mr. Rigali previously in response to a call from

Mr. Rigali who had heard about the Carter Company's medical factoring program from Wilson's brother. Wilson met with Harelson on July 1, 1983 after setting up an appointment in response to her call.

The content of the meeting with Harelson and the two meetings with first Mr. Rigali and then both Rigalis was substantially the same. Using the brochure produced by the Carter Company, Plaintiff Exhibit No. 16, Wilson explained that the Carter Company factored medical claims by purchasing, at a discount, the right of doctors to collect on accounts receivable from insurance companies. He represented that the doctors remained liable to the Carter Company for the claims, and that the Carter Company only dealt in claims that involved doctors and insurance companies that it felt were responsible.

Wilson also described the investment. He explained that the investor would receive a return of seven percent every 90 days on the amount invested. However, he also indicated that the rate of return could vary from an annual rate of 20 percent up to an annual rate of 30 or 33 percent depending on how successful the Carter Company was at collecting on the claims. There was no negotiation of the rate of return between Wilson and the plaintiffs.

Wilson also explained that investors would receive promissory notes. Although Harelson apparently believed they would be from Mr. Carter personally, the brochure explained that they would be from the Carter Company. The plaintiffs did receive promissory notices from the Carter Company that indicated a seven percent quarterly interest rate and a 90-day term.

Wilson also represented that in the seven-year history of the Carter Company it had never failed to pay an investor and that he had invested in the Carter Company and had benefitted. He further represented that he had met Mr. Carter who was a man of substantial means, and that he, Wilson, had visited the Carter Company.

At the conclusion of both the June 22, 1983 meeting with the Rigalis, and the July 1, 1983 meeting with Harelson, Wilson helped the plaintiffs complete the forms and he accepted the checks that were forwarded to the Carter Company.

Finding the facts to be as stated, the Court is compelled to further find that Wilson was a substantial factor in the sale of the interests in the medical factoring program to Harelson and the Rigalis.

Although defendants have urged the Court to conclude that Wilson was merely a conduit providing routine services, and, therefore, could not be liable as a seller, the Court disagrees. Where, as here, "the defendant engaged in a high degree of individual effort to sell the security and . . . has been in actual contact with the plaintiff[s]," In re Fortune Systems Securities Litigation, 604 F. Supp. 150, 161 (N.D. Cal. 1984), the Court cannot conclude that the law precludes the imposition of seller liability.

C. Does the Statute of Limitations Bar Part of the Section 12(1) Claim?

Section 13 of the Securities Act of 1933, 15 U.S.C. section 77m, provides that a suit to enforce a liability created under section 12(1) is barred unless brought within one year of the violation upon which it is based. The Court

measures the running of the statute from whichever of the defendant's activities--offer, sale, or delivery--occurred last. Doran v. Petroleum Management Corp., 576 F.2d 91, 93 (5th Cir. 1978).

This case was filed on June 25, 1984. The Rigalis signed the factoring agreement and gave it and their first check for $6,000 to Wilson on June 22, 1983. However, the Miller Financial Corporation did not receive the money and agreement until June 27, 1983, and the promissory note and factoring agreement countersigned by the Carter Company were not returned to the Rigalis until sometime thereafter. Consequently, the delivery of the security was the last act. Having determined that delivery occurred after June 25, 1983, the Court concludes that this action against a seller of an unregistered security is not time barred.

D. Violation of Section 12(1).

There is no dispute that the Carter Company did not file a registration statement. See Plaintiff Exhibit No. 47 (S.E.C. certificate of non-registration). As the Court has concluded that Wilson was a seller of securities, and that the securities were unregistered, he is liable for damages equal to the consideration paid for the securities plus interest. 15 U.S.C. section 77l.

E. Liability Under Section 12(2).

To prevail in an action under section 12(2) of the Securities Act, plaintiffs must prove not only that there was a sale of a security, but that it was by means of a communication that included an untrue statement or omission of a material fact. Section 12(2) provides a "reasonable care" defense such that a seller who did not know, and in the exercise of reasonable care could not have

known, of the untruth or omission in the offer or sale of the security cannot be liable. 15 U.S.C. section 771(2).

Although plaintiffs alleged a number of misrepresentations and omissions, [5]

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[5] Plaintiffs have alleged the following misrepresentations:

1. that the Carter Company would use the contribution to factor medical claims, when, in fact, the money was invested in other high risk securities;

2. that investing in medical factoring is one of the safest ways to make an excellent return;

3. that the Carter Company checks out each insurance claim or account receivable to verify the safety of the purchase;

4. that the Carter Company had engaged in factoring for seven years without a single account that it had purchased going unpaid;

5. that the rate of return had been seven percent per quarter for the previous several years;

6. that the principal and interest would be returned at the end of each 90-day cycle by giving two weeks written notice; and

7. that investing in medical factoring through the Carter Company was an excellent way to generate high current income. First Amended Complaint at 9-10.

[Continued on next page]

they only adduced evidence tending to support the allegation that the Carter Company did not use plaintiffs' money for medical factoring and so it was a misrepresentation (and omission) to assert that the money would be so used.

To attempt to prove that the Carter Company was not operating a medical

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[5] [Continued from previous page]

In their trial brief, plaintiffs add the following purported misrepresentations:

8. that Mr. Carter was wealthy and had been offering this investment for years;

9. that Wilson said he investigated the Carter Company and Mr. Carter and that they were reputable; and

10. that the brochure accurately described where the money would go. Plaintiffs Trial Brief at 2. Plaintiffs have alleged the following omission:

1. that the contribution would not be invested in a medical factoring program;

2. that the funds would be used for high risk investments; and

3. that the Carter Company was not experienced in making high risk investments.

factoring program, plaintiffs relied on the testimony of Claudia Grossfeld. Grossfeld, who was a credible witness, testified that in her capacity as a law clerk for the Los Angeles Regional Office of the Securities and Exchange Commission she examined the records of the Carter Company on December 3, 1983. She further testified that she was unable to discover any records relating to any kind of factoring business. However, when confronted on cross-examination with a document purporting to be a computer printout of the factoring records, she acknowledged that she had never seen such a document.

The Court gives very little weight to the testimony of Grossfeld on the issue of whether or not it was a misrepresentation to say that there was a medical factoring program in which plaintiffs' money would be invested. The Court has doubts that

Grossfeld's examination, as she described it, was thorough enough to rule out the possibility that there were undiscovered medical factoring records. The Court is skeptical about the thoroughness of the Grossfeld search particularly in light of Wilson's testimony that Mr. Carter had told Wilson that the records were kept confidential to prevent employees from leaving with proprietary information and starting competing businesses. Moreover, the examination was in December of 1983 which was six months after Wilson had made representations about the factoring program. That concealed records were not found six months after the representation, and three months after the last investment, is unpersuasive circumstantial evidence that the program did not actually exist at the time the representations and investments were made.

Thus, the Court finds that plaintiffs failed to sustain their burden of proving the existence of a misrepresentation as they failed to prove that the medical factoring program did not exist, and they produced no evidence as to how the invested money was actually spent.

Based on the very credible testimony of Wilson, the Court finds that he took the following actions to investigate the Carter Company:

a. he personally met Mr. Carter in July of 1982;

b. he again personally met Mr. Carter in late July or early August of 1982;

c. he reviewed a Dun & Bradstreet report on The Carter Company, Defendant Exhibit No. B;

d. he reviewed the financial statements of Tom Carter Enterprises,

Inc., which he believed was not a separate entity from the Carter Company;

e. he discussed the Carter Company with a Mr. Terry Patton who claimed to have checked out Mr. Carter's bank references and bank accounts and said that the bank balances were in the millions of dollars;

f. he visited the offices of the Carter Company in November of 1982;

g. he talked to Larry Hastings who, along with a CPA, had done some investigation of Mr. Carter;

h. he read a letter from Ron Wiener to Mark Miller in which Wiener asserted that he had reviewed the medical factoring program and could find no irregularity in the handling of client money. The letter asserted that documents in support of that conclusion would be forthcoming from a "big eight" accounting firm;

i. he met again with Mr. Carter on June 16, 1983 at which time, in response to a question, Carter said the only complaint about the program by an investor had been from someone who said her check arrived late;

j. he had made investments in Carter Company notes and received regular payments of principal and interest;

k. he contacted the Better Business Bureau about the Carter Company and found that no complaints had been reported;

l. he became aware that the Carter Company had met ADP's prudent investor requirements;

m. he was shown computer printouts purporting to reflect Carter Company activities in the factoring business; and

n. when another investor commented on an apparent discrepancy between two financial reports of Mr. Carter's assets, Wilson sought an answer from Mr. Miller

who provided an explanation and who also called the Carter Company.

Finding the facts to be as just described, the Court concludes that there was no misrepresentation in the assertion by Wilson that he had investigated Mr. Carter and the Carter Company and found them to be reputable.

Moreover, the Court also finds, based on the testimony of Wilson, that he did not know of any untruth or omission at the time he made the statements to plaintiffs.

In sum, the Court cannot conclude that Wilson should have known of the alleged untruths or omissions. Not only have the alleged misrepresentations and omissions not been proved to this Court, but the evidence shows that Wilson exercised more than reasonable care for someone in his position in investigating these investments. See Sanders v. John Nuveen & Co., 619 F.2d 1222, 1228 (7th

Cir. 1980), _cert_. _denied_, 450 U.S. 1005 (1981) (what constitutes reasonable care depends on the circumstances);
3A H. Bloomenthal, _Securities and Federal Corporate Law_, section 8.05[2] at 8-31 (1985) (duty of reasonable care varies depending on the nature of the transaction and role of defendant). Consequently, the Court concludes that Wilson did not violate section 12(2) of the Securities Act of 1933.

II. Fraud.

Scienter is an essential element of fraud under both Rule 10b-5 and the common law. _See_ 4 B. Witkin, _Summary of California Law_ 2728 (1974) (common law); _Nelson v. Serwold_, 576 F.2d 1332, 1336-1337 (9th Cir.), _cert_. _denied_, 439 U.S. 970 (1978) (Rule 10b-5).

No evidence was adduced indicating that Wilson knew that any of his representations were false. Wilson

credibly testified that he never received information from any source that suggested that the Carter Company was not engaged in medical factoring. Thus, the Court finds that Wilson had no knowledge that anything he represented to plaintiffs was not true.

In light of the efforts made by Wilson to investigate the Carter Company, the Court further finds that Wilson was not negligent, much less reckless, in making the representations that he made to plaintiffs. Consequently, an essential element is lacking for a finding of liability under common law fraud or Rule 10b-5.

Plaintiffs have also contended that Wilson violated Rule 10b-5 by impliedly representing that he had an adequate basis for recommending the investment. Because of the special relationship of a broker to a securities buyer, a broker implicitly represents that he has an adequate basis

for the opinions he renders, Hanly v. Securities and Exchange Commission, 415 F.2d 589, 596 (2d Cir. 1969). There was virtually no evidence that Wilson was a broker. Moreover, no evidence was adduced indicating that Wilson made a recommendation. Finally, given the investigating he did, there is no indication that Wilson would not have had an adequate basis for a recommendation had he made one. Consequently, the Court concludes that there was no fraud or violation of Rule 10b-5 under this, or any other, theory.

III. Breach of Fiduciary Duty.

Plaintiffs predicate their claim for breach of fiduciary duty on the premise that Wilson was a financial advisor to these plaintiffs. The evidence indicates that he was not.

In addition to his activities in connection with the sales of the medical

factoring investments, the evidence indicates that Wilson had rather limited contact with the plaintiffs. He discussed the possibility of an investment in a different venture with Mrs. Rigali, and he also gave her a book about tax shelters. However, the testimony indicates, and the Court finds, that the plaintiffs never discussed their overall financial goals with Wilson, Wilson never recommended that any investments be undertaken, and plaintiffs never paid Wilson any fee for providing financial advice. The Court concludes that Wilson was not a financial advisor to plaintiffs and therefore owed them no fiduciary duty.

CONCLUSION

The Court finds that Wilson sold an unregistered security in violation of section 12(1) of the Securities Act of 1933. The Court further finds that Wilson did not commit common law fraud or breach

a fiduciary duty, nor did he violate Rule 10b-5 or section 12(2) of the Securities Act of 1933. Consequently, plaintiffs are not entitled to any punitive damages, but they are entitled to damages equal to the amount of the consideration paid for the securities, plus interest, less an offset equal to the amount received from the other defendants. The above shall constitute the required findings of fact and conclusions of law required under Rule 52 of the Federal Rules of Civil Procedure. The plaintiffs are ordered to submit a judgment consistent with this opinion.

IT IS SO ORDERED.

DATED: June 3, 1986

EUGENE F. LYNCH
United States District Judge